Shermag

2002•2003 Annual Report

Summary

Our Mission

Shermag's corporate mission is to produce the highest quality furniture available in the marketplace. While fully aware of the importance of assuring the Company's shareholders a positive return on their investment, Shermag's management is also concerned about offering fair working conditions to its 2,300 employees.

Company Profile

Shermag is a leader in the production and distribution of high-quality residential furniture. The Company enjoys an enviable reputation in the North American market and figures prominently in the design of contemporary-style furniture.

Shermag's facilities include a network of medium-size factories equipped with state-of-the-art technology. Vertical integration – from the forest to the retailer – gives the Company an exceptional competitive edge in a highly fragmented industrial sector. Three hardwood sawmills, a plant specializing in the fabrication of components, and a veneer plant all contribute to the efficiency of the Company's eleven furniture manufacturing facilities and to a lowering of production costs.

Shermag focuses on specific markets in the sale of its products. Major department stores in the United States and Canada, multiple-location chain stores specializing in the distribution of high-end furniture, as well as the best independent retailers comprise the Company's marketing targets.

April 4 2003	April 5 2002	March 30 2001	March 31 2000	April 2 1999
195,464	165,657	164,914	154,328	128,134
181,297	152,797	153,746	144,391	120,594
143,337	119,745	128,821	123,444	100,245
73%	72%	78%	80%	78%
56,344	44,998	48,436	46,319	38,383
24,535	11,036	19,731	16,665	13,105
31,839	20,218	28,744	25,373	19,519
16,156	7,172	13,338	11,106	8,704
13,295,724	13,292,724	13,184,474	13,208,774	13,284,674
1.22	0.54	1.01	0.84	0.66
1.20	0.54	1.00	0.83	0.66
8.52	7.30	6.76	5.79	4.96
11.25	12.25	7.00	7.00	9.30
9.4x	22.7x	7,0x	8.4x	14.1x
147,888	140,600	151,974	142,735	131,556
65,447	55,015	45,426	37,299	31,057
463	9,289	10,726	12,205	13,224
113,697	97,522	89,598	76,976	66,378
23,182	14,520	20,538	17,912	14,186
28.83%	27.16%	29.37%	30.01%	29.96%
8.27%	4.33%	8.09%	7.20%	6.79%
16.29%	12.20%	17.43%	16.44%	15.23%
3.82:1	3.38:1	2.11:1	1.84:1	1.71:1
0.00:1	0.09:1	0.12:1	0.16:1	0.20:1
15%	8%	16%	16%	14%

s receivable

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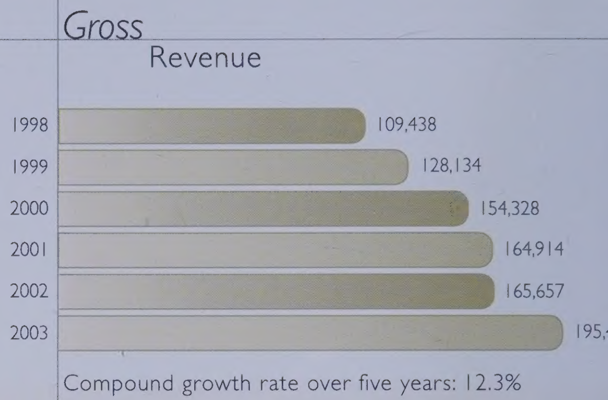
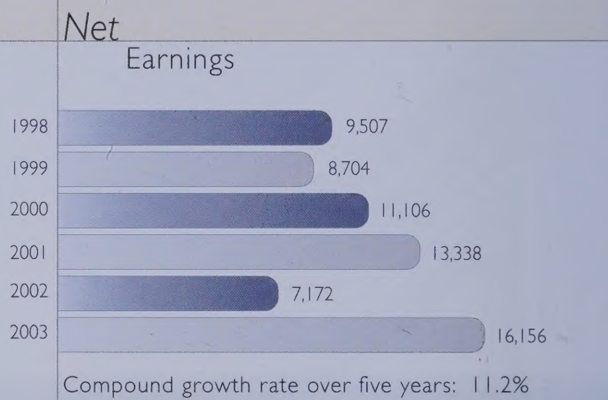
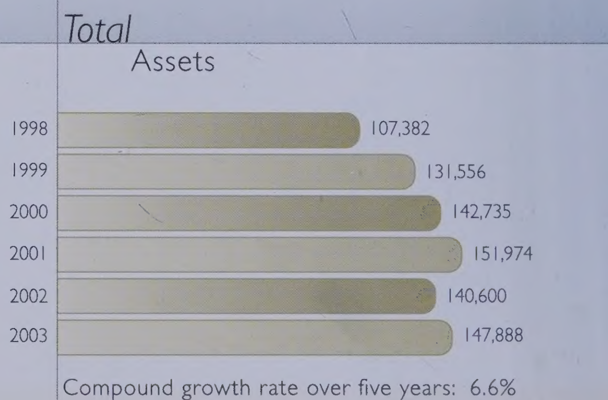
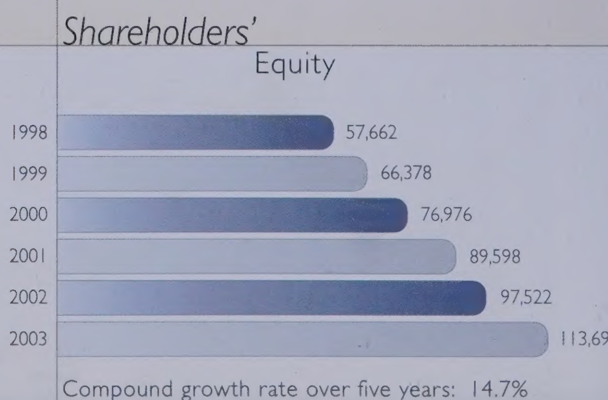
Company Profile









Financial Highlights

Year ended (in thousands of dollars, except ratios and per share data)	April 4 2003	April 5 2002	March 30 2001	March 31 2000	April 2 1999
Operating results					
Gross revenue	195,464	165,657	164,914	154,328	128,134
Net revenue	181,297	152,797	153,746	144,391	120,594
Exports	143,337	119,745	128,821	123,444	100,245
Exports as % of gross revenue	73%	72%	78%	80%	78%
Gross profit excluding amortization	56,344	44,998	48,436	46,319	38,383
Earnings before income taxes	24,535	11,036	19,731	16,665	13,105
Earnings before interest, taxes, depreciation and amortization (EBITDA)	31,839	20,218	28,744	25,373	19,519
Net earnings	16,156	7,172	13,338	11,106	8,704
Common shares outstanding at year end	13,295,724	13,292,724	13,184,474	13,208,774	13,284,674
Earnings per share results					
Net earnings	1.22	0.54	1.01	0.84	0.66
Diluted net earnings	1.20	0.54	1.00	0.83	0.66
Book value	8.52	7.30	6.76	5.79	4.96
Market price	11.25	12.25	7.00	7.00	9.30
Price earnings ratio	9.4x	22.7x	7,0x	8.4x	14.1x
Financial situation					
Total assets [1]	147,888	140,600	151,974	142,735	131,556
Working capital	65,447	55,015	45,426	37,299	31,057
Long-term debt	463	9,289	10,726	12,205	13,224
Shareholders' equity	113,697	97,522	89,598	76,976	66,378
Cash flow from operations	23,182	14,520	20,538	17,912	14,186
Ratios and returns					
Gross margin	28.83%	27.16%	29.37%	30.01%	29.96%
Net profit margin	8.27%	4.33%	8.09%	7.20%	6.79%
EBITDA margin	16.29%	12.20%	17.43%	16.44%	15.23%
Current ratio [1]	3.82:1	3.38:1	2.11:1	1.84:1	1.71:1
Long-term debt ratio	0.00:1	0.09:1	0.12:1	0.16:1	0.20:1
Return on equity	15%	8%	16%	16%	14%

[1] After reclassification of accruals for advertising and volume rebate in deduction of accounts receivable

Message to Shareholders

This year, we present photo images depicting people living the Shermag experience. Last year, the annual report was dedicated to our employees who create the Shermag experience.

Shermag had its best year ever in fiscal 2002-2003, an accomplishment that is particularly satisfying given the difficult overall business environment of the past couple of years. We have pursued a focused plan in recent years; improving operational management along the entire supply chain, regularly introducing new furniture collections and aggressively pursuing better market penetration with the Company's segmented marketing strategy. As a result, sales reached a record $195 million while year over year net earnings more than doubled from $0.54 per share in fiscal 2001-2002 to $1.20 per share this year.

Subsequent to year-end, Shermag acquired the Jaymar Furniture Company, an established 47 year old organization and Canada's leading manufacturer of high quality special-order leather and fabric upholstered furniture. We fully expect that this transaction will be immediately accretive to Shermag's profitability.

The Benefits of Jaymar

The purchase of Jaymar will not only add to our profits, but it is highly strategic. This addition reinforces Shermag's status as a full line, quality furniture manufacturer and will help achieve a critical mass in upholstered furniture. Our strength and indeed, our reputation, have been built in bedroom and dining room collections. The Jaymar addition now allows us to move into the living room sector, creating virtual one-stop shopping with our retail partners.

This greatly enhances the Shermag model of granting territorial exclusivity for our various collections to our network of retail partners, which include top department stores, dominant regional furniture chains, national retail chains and independent furniture stores. We have traditionally done well in our core customer base of department stores and regional furniture chains. A particular focus for growth has been the independent sector.

While we made noteworthy progress over the past year with this group of retailers through aggressive sales and product development efforts, Jaymar's primary account base has traditionally been with these independents. The combination gives us powerful cross-selling synergies, which we believe will bring added growth in revenue and earnings to both companies. Furthermore, Jaymar's successful expansion into the home theater category, coupled with its experience in motion furniture, has made it a value-oriented resource in this new lucrative niche market.

Executing Our Plan

A significant priority had been to strengthen supply chain management and increase production levels from existing facilities through efficiency improvements and the introduction of night shifts. This detailed attention to operations and to improving cost controls has brought the desired results. For the fiscal year, production from existing facilities increased 13% over prior year levels.

The turnaround of our sawmill operations, initiated almost two years ago, has continued. The sector maintained profitability as its performance levels grew, thus contributing to overall margin enhancements. For the full year, company-wide margins increased over 100 basis points to 28.8%, while in the fourth quarter of the year just concluded, gross margins rose to 30.9% compared to 27.1% in fiscal 2001-2002.

Product Development

Aggressive product development ensured that Shermag's various divisions provided its retail partners with exciting merchandise at compelling values to compete effectively.

Several new collections were introduced at the Spring High Point Show with a major effort in the master dining room category. Five new formal dining collections were shown, all oriented around specific lifestyles. Another introduction was a collection of sophisticated upholstered dining chairs, styled to provide retailers with more contemporary options for its current successful dining programs. In addition, three new bedroom collections were successfully launched with a focus on fashion forward trends in the traditional, casual contemporary and modern lifestyles.

Import Division

The import initiative launched in 2001-2002 saw the creation of an experienced professional sourcing and quality control team. Sourcing relationships in the Orient were secured and strengthened, allowing for the introduction of new items featuring more intricate designs. These traditional designs contrast the clean, casual, contemporary styles that characterize Shermag's domestic collections. A number of new dining room and bedroom collections have been successfully launched. Shipments for the year significantly exceeded our plan.

Outlook

Shermag has made considerable progress in attaining the business objectives established at the outset of the year. We have been able to increase sales and generate strong cash flow despite the very difficult business environment. Debt levels were significantly reduced again this year, decreasing from $16.5 million at the end of fiscal 2001-2002 to under $1 million, which was non-interest bearing, as at April 4, 2003. Notwithstanding the Jaymar financial acquisition and the resultant financial commitment, the Company remains in a strong position able to consider other investment opportunities if they meet our stringent criteria.

As the economy remains difficult to gauge and indeed, to forecast, we remain committed to our strategies. This environment demands that we continue to leverage our operations and channels of distribution to create further growth, and we must ensure that our retail partners have compelling products for those consumers willing to purchase, and above all, we must remain cautious and flexible to change.

A Word of Thanks

It has been an exciting and highly productive year. In June 2002, we marked our 25th Anniversary with a day long, fun-filled event for all of our employees and their families. These Shermag people have clearly demonstrated their willingness and ability to work together in implementing our business plans. The successes achieved speak to their energy, skill and dedication to take our Company to yet another level. We welcome Jaymar's 300 skilled tradesmen and look forward to working with them as part of the growing Shermag family. Sincere thanks to our retail partners who are increasingly demonstrating their confidence in our workmanship and products. To our loyal shareholders, a heartfelt thank you for your continued support. And finally, our sincere appreciation to our Board of Directors whose stewardship and guidance create a demanding yet encouraging culture.

Jeffrey K. Casselman
President and Chief Executive Officer

Management's Discussion and Analysis
of Operating Results and Financial Position

Shermag's mission is to manufacture residential furniture of the best design and quality available on the market, to assure its shareholders a positive return on their investment while providing fair working conditions to its employees.

The purpose of this analysis of the financial position and operating results of Shermag Inc. ("Shermag" or "the Company") is to provide the reader with an overview of how the financial position changed between April 5, 2002 and April 4, 2003. It also compares the operating results and cash flow for the twelve-month period ended April 4, 2003 to those for the same period the previous year. It should be noted that the fiscal year ended April 4, 2003 covers a 52-week period while the 2002 fiscal year covered 53 weeks. This analysis should be read in conjunction with the Company's consolidated financial statements dated April 4, 2003 and the notes thereto.

Forward-Looking Statements

In the interest of providing shareholders and potential investors with information regarding Shermag, including management's assessment of future plans and operations, certain statements in this management discussion and analysis are forward-looking statements subject to risks, uncertainties and other important factors that could cause the Company's actual performance to differ materially from those expressed in or implied by such forward-looking statements.

Such factors include, but are not limited to: the impact of general economic conditions in Canada and the United States; industry conditions including changes in laws and regulations; increased competition; the lack of availability of qualified personnel or management; fluctuations in commodity prices; foreign exchange or interest rates; stock market volatility; and the impact of accounting policies issued by Canadian and American standard setters. Some of these factors are further discussed under "Risks and Uncertainties" in this management discussion and analysis.

Although the Company believes that the expectations conveyed by the forward-looking statements are reasonable, based on information available to it on the date such forward-looking statements were made, there can be no assurance that such expectations will prove to be correct. All subsequent forward-looking statements, whether written or orally attributable to the Company or persons acting on its behalf are expressly qualified in their entirety by these cautionary statements.

OVERVIEW, BUSINESS STRATEGY AND MARKET TRENDS

Overview

Shermag produces high quality furniture, including glider rockers, dining room and bedroom furniture, and occasional and upholstered furniture. Except for its upholstered furniture, the Company's products are made of solid wood and veneer, supplied mainly by the Company's sawmills and veneer plant. In 2001, Shermag also created a new division to import finished furniture from Asia, a growing trend in the United States.

Shermag's activities are divided into two sectors: furniture and sawmill operations. However, the primary purpose of its sawmill operations is to provide a reliable supply of raw material at advantageous prices for the Company's furniture plants. Consequently, the Company does not report its financial results by segment.

Shermag's furniture sector manufactures, imports and distributes household furniture. It operates eleven furniture-manufacturing plants as well as two additional plants that specialize in wood and veneer components.

Management's Discussion and Analysis
of Operating Results and Financial Position

In recent years, Shermag has also moved to expand more aggressively its distribution into independent furniture dealers, an initiative that the Company will continue to focus on.

The Company's sawmill sector consists of three sawmills: Mégabois Inc., Scierie Montauban Inc. and Shermag Corp. dba Woodtek, which supply approximately 90% of the hardwood requirements of the Company's furniture plants. Only excess sawmill production and sawmill products unsuitable for furniture manufacturing are sold on the outside market.

The Company's operations employ a workforce of 2,300 people. With the exception of one sawmill and the wood by-products plant located in North Anson, Maine in the United States, all of the Company's facilities are in Canada, in the provinces of Québec and New Brunswick.

Business Strategy

Shermag's mission is to manufacture residential furniture of the best design and quality available on the market, to assure its shareholders a positive return on their investment and to offer fair working conditions to its employees.

Shermag's operating strategy begins with the vertical integration that permits it to exert tight control over its sources of supply. More than 90% of the hardwood and 80% of veneer it uses is produced at its own plants. This affords the Company greater price stability for its raw material and protects it from sudden, massive price hikes such as have been experienced from time to time. By controlling its sources of supply, Shermag is also able to provide for the particular needs of its factories in terms of the dimensions and types of wooden parts, thus optimizing raw-material utilization. This in turn enables the Company to offer better products at very competitive prices.

Shermag's marketing strategy is based on a segmentation of the market into three specific categories: major department store chains, independent furniture dealers and national North American mass market chains. The Company is committed to establishing enduring partnerships with its customers in these segments, supplying them with quality product on an exclusive basis in their trading areas. The exclusivity concept assures Shermag control over distribution of its products in a given territory and provides higher profit margins for its business partners.

Shermag's growth strategy is first and foremost focused on doing more with its existing operations. The Company operates with small entrepreneurial divisions where management is more deeply involved in operations and can produce better results. In recent years, management has focused on improving this depth of management and in-plant supervision.

The next element of its strategy is to leverage existing channels of distribution by offering new product categories. This requires continuous improvement and the constant redefinition of products manufactured by each division. The Company has begun importing furniture featuring more detailed designs in contrast to the clean, casual, contemporary lines that characterize its domestic furniture. Such global sourcing is an effective way to create growth without committing to significant new infrastructure. This initiative also serves to extend the loyalty of Shermag's existing retail partner base and helps broaden the product assortment, allowing for expanded distribution to new customers.

In recent years, Shermag has also moved to expand more aggressively its distribution into independent furniture dealers, an initiative that the Company will continue to focus on.

Management's Discussion and Analysis
of Operating Results and Financial Positio

Low mortgage rates, growing employment and increased incomes are all factors that have contributed to record levels of home sales and home improvement, both of which should drive furniture sales.

Finally, Shermag is open to growth through strategic acquisitions that can be easily integrated into its current operations and provide a complement to its existing product lines and markets. This was the case with Jaymar Furniture Company, which the Company acquired subsequent to year-end 2002-2003. Jaymar adds capability in the living room environment to Shermag's traditional strengths in bedroom and dining room furniture. Jaymar also has a strong presence with the independent furniture dealers, which Shermag had targeted as a sector with good growth potential. Lastly, Jaymar's presence in the home theatre category, coupled with its experience in motion furniture, provides Shermag with an entry into this new lucrative niche market.

Key Performance Indicators

Shermag measures its performance on a company-wide basis through key financial indicators that include sales, gross profit, EBITDA, working capital, long-term debt-to-equity ratio and earnings per share. These items are discussed in the appropriate sections under "Results of Operations", below.

Management also tracks performance within each division through certain indicators related to operations. These include cost of labour, cost of material, efficiency of capital utilization and attainment of cost reduction targets.

Market Trends

Much of the furniture market is directly related to the housing market, with changes in the level of orders for housing-related furniture products arriving about several months after any changes in housing starts. New home construction and resale home activity was strong in 2002, both in Canada and in the United States, and is expected to continue into 2003. Low mortgage rates, growing employment and increased incomes are all factors that have contributed to record levels of home sales and a renewed interest in home remodeling and improvement, both of which should encourage purchases of new and upgraded furniture.

With the opening up of global markets, the importing of Asian-built furniture is a growing trend for North American furniture manufacturers. Shermag created a new division in late 2001 to import finished furniture from Asia, and has seen strong growth in sales of this furniture since the first collections were introduced in early 2002.

The trend toward home offices and telecommuting also continues to be strong. It is estimated that nearly 45 million households in the United States now have home offices, many of which include special furniture to accommodate computers. Shermag is presently developing prototypes for the home office market.

RESULTS OF OPERATIONS

Sales

For the year ended April 4, 2003, the Company posted record gross revenues of $195.5 million, for a gain of 18% over last year's gross revenues of $165.7 million. This dramatic improvement can be traced to several initiatives taken in fiscal 2001-2002 in response to a challenging economic climate. These included strengthening the Company's sales structure and promoting its presence in large independent furniture stores, in addition to launching new collections and creating a new division to import finished traditionally styled furniture from Asia.

Results by Division

Scotstown Division

Sales for the Scotstown division were up 8% over fiscal 2001-2002. The Division's three plants manufacture bedroom and dining room furniture as well as occasional furniture. Two new collections were developed in record time during the year and were successfully launched. Production also improved by 15% during the year. The Division has ample production capacity, and plans to increase output in the current year while reducing costs at its plants.

Bédard Division

The Bédard division, which produces dining room furniture, reported 26% sales growth for fiscal 2002-2003. Two new collections were successfully launched resulting in the addition of 100 new store accounts as well as an expansion of floor space for our dining presentations at many of our major retail partners. Plant capacity was improved with the addition of a second shift at the Saint-Etienne plant.

The Division anticipates continued growth in the current year, given a backlog position 26% higher than last year's level. Just-in-time production will help reduce delivery times and provide a service advantage over Asian imports. The Division is also working to reduce its operating, raw material and labour costs.

Nadeau Division

2002 had presented Nadeau with the bankruptcy of a major customer and one of its poorest ever results. During the course of 2002, management restructured the New Brunswick facilities to eliminate non-value added activity and improve shop floor supervision. In fiscal 2002-2003, the Nadeau division translated the hard work of fiscal 2001-2002 into improved results. Sales were up over 12% for the year and production rose by over 14%, while labour costs were trimmed by 3%.

The Division nevertheless faces difficult challenges as demand for its primary collections is flat. The main objective for Nadeau is to develop new collections which will provide demand to fill the Division's significantly underdeveloped production capacity.

HPL Division

After underperforming expectations in fiscal 2001-2002, sales for the HPL division grew by 16% in fiscal 2002-2003. The Division produces the *Heritage* bedroom furniture collection. Production at the division increased by 13% following the introduction of a second shift at its plant and an aggressive program to improve raw material usage.

Two new collections launched in fiscal 2002-2003 were well received and are being displayed by many of the Company's major customers. Work is now underway on updating two of the existing collections. The Division is working very hard to stay ahead of the competition and plans growth in sales, output and productivity in the current year.

Chandéric Division

The Chandéric division, maker of Shermag's glider rockers, increased sales by 17% in fiscal 2002-2003 to post record sales for the year.

The Division plans for continued growth in fiscal 2003-2004. New initiatives include the introduction of a full line of juvenile furniture and systematic penetration of independent juvenile furniture stores, as well as cost reduction through improved material sourcing and increased plant productivity.

Sofas International

A producer of high quality upholstered furniture, Sofas International restructured during the year in a move to turn around deteriorating financial performance .The changes included a new general manager and a new plant manager who brought to the Division a renewed focus on plant efficiency and service. The Division improved its financial performance in the fourth quarter of the year.

The highlight of the year for Sofas International was winning the 2003 Grand Medallion, the top award for excellence of design and marketing, presented by combined Canadian Furniture Manufacturers Associations, at the January 2003 Toronto Furniture Show. For the current year, the Division is planning to stay ahead in a highly-competitive market by creating new upholstered products, among them a line of upholstered dining room chairs. This initiative is aimed at expanding its customer base overall and achieving a significant increase in its sales of dining room chairs.

Management's Discussion and Analysis
of Operating Results and Financial Position

With the higher gross profit for the year and proportionally lower selling and administrative expenses, the Company's earnings before interest, income taxes, depreciation and amortization (EBITDA) were up over 50% for the year.

Import Division
Barely into its second year, the imported furniture division began shipping at an impressive rate, exceeding its revenue targets. The Division created an exclusive, professional sourcing and quality control team, strengthened its manufacturing relationships and developed a stocking program in China to facilitate consolidation of customer-direct shipments.

Two collections were launched for fall 2002 distribution and six collections were in place for spring 2003 shipping. An additional five collections were designed and prototyped during the year and will be ready for fall 2003 shipping. The Division achieves considerable cost savings by working directly with most of the factories, without the use of manufacturing agents.

Gross Profit
The Company showed gross profit excluding amortization of $56.3 million for fiscal 2002-2003 compared to $45 million for the previous year. Gross profit rose to 28.8% of sales for the year from 27.2% in fiscal 2001-2002. Quarterly results for the year just ended show that gross profit rose in the second half of the year, reaching 30.9% of sales in the fourth quarter.

The improvement in gross profit was mainly due to a substantial drop in the cost of sales in the fourth quarter of fiscal 2002-2003, to 61.3% of sales from the 64-66% range, where it had been. This brought the average cost of sales for the year down to 63.9% of sales compared to 65.1% last year. A slightly lower level of returns, allowances and discounts in fiscal 2002-2003 also contributed to the higher gross profit.

Selling and Administrative Expenses
At $25 million, selling and administrative expenses represented 12.8% of sales in fiscal 2002-2003, compared to $24.2 million or 14.6% of sales the previous year. The improved performance in 2002-2003 is related to containment of cost growth to levels lower than the growth of sales and the non-recurrence of the significant receivable loss associated with the HomeLife bankruptcy.

EBITDA
With the higher gross profit for the year and proportionally lower selling and administrative expenses, the Company's earnings before interest, income taxes, depreciation and amortization (EBITDA) were up over 50% for the year, at $31.8 million compared to $20.2 million in fiscal 2001-2002.

Financial Expenses
Interest on bank loans dropped dramatically in fiscal 2002-2003 to $229,000 from $1.2 million a year earlier. Interest on long-term debt also declined substantially, to $220,000 from $517,000.

Amortization
Amortization fell in fiscal 2002-2003 to $6.9 million or 3.5% of sales from $7.5 million or 4.5% of sales the previous year. This improved performance is explained by the Company's implementation in 2001 of a conservative capital re-investment strategy designed to ensure investments are made only after factory management has achieved adequate labour and material conversion efficiencies.

Income Taxes
In fiscal 2002-2003, the Company's effective tax rate returned to its usual level of 34.2%. The 35% rate for fiscal 2001-2002 was unusually high as no income tax recovery was assumed on the losses of its American sawmill subsidiary.

Management's Discussion and Analysis
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Net earnings for fiscal 2002-2003 were $16.2 million, more than double the $7.2 million recorded last year. Net earnings per share amounted to $1.22 basic and $1.20 diluted compared to $0.54 basic and diluted last year.

Net Earnings
Net earnings for fiscal 2002-2003 were $16.2 million, more than double the $7.2 million recorded last year. Net earnings per share amounted to $1.22 basic and $1.20 diluted compared to $0.54 basic and diluted last year. Basic earnings per share are based on a weighted average of 13.3 million shares outstanding in fiscal 2002-2003 compared to 13.2 million last year, while diluted figures reflect weighted averages of 13.5 million shares outstanding this year and 13.3 million last year.

LIQUIDITY AND CAPITAL RESOURCES

At April 4, 2003, the Company had cash and cash equivalents of $6.1 million, up from $2.8 million a year earlier. The Company also has access to total operating credits of $32.5 million in bank loans or acceptances that can be used to support the Company's operations, future acquisitions and foreign exchange risk. At April 4, 2003, no funds were drawn on this credit line.

Operating Activities
Operating activities generated net cash flow of $22.9 million in fiscal 2002-2003 compared to $24.4 million the previous year. While net earnings contributed an additional $9 million in fiscal 2002-2003, changes in non-cash working capital items added virtually the same amount, $9.9 million, to cash flow in fiscal 2001-2002.

Changes in non-cash working capital items reduced cash flow by a net $0.2 million in fiscal 2002-2003. Having been reduced by $5 million the previous year, accounts receivable grew by $2.7 million in fiscal 2002-2003. Inventories also rose by $4.6 million after declining by $6.3 million in fiscal 2001-2002. These two items were offset by increases in accounts payable and income taxes payable of $3.2 million and $3.8 million respectively for fiscal 2002-2003.

Investing Activities
The Company used cash flow of $3.9 million in its investing activities during fiscal 2002-2003 compared to $4.2 million the previous year. Capital expenditures were up slightly to $2.4 million as compared to $2.1 million in fiscal 2001-2002. Deferred charges also accounted for investments of $1.6 million compared to $2.2 million a year earlier.

Financing Activities
In fiscal 2002-003 as in fiscal 2001-2002, the Company used the bulk of its cash flow to reduce debt, in keeping with its stated goal of strengthening its balance sheet. A total of $15.8 million was applied in 2002-2003 to reduce bank loans and acceptances by a net $5.8 million and long-term debt by $10 million. A similar $15.9 million was used the previous year to achieve a reduction of $14.4 million in bank loans and $1.5 million in long-term debt.

In fiscal 2002-2003, 3,000 treasury shares were issued pursuant to the exercise of options, for a consideration of $19,000. This compares to 108,250 shares issued in fiscal 2001-2002 for a cash consideration of $752,000.

Consolidated Balance Sheets
At April 4, 2003, the Company had total assets of $147.9 million, up from $140.6 million at April 5, 2002. The increase was mainly attributable to the rise in cash and cash equivalents as well as higher accounts receivable and inventories.

Total liabilities fell by $8.9 million during fiscal 2002-2003 to stand at $34.2 million at April 4, 2003. Increases of $3.2 million in accounts payable and accrued liabilities and $3.8 million in income taxes payable were more than offset by $15.8 million in combined debt reduction. It should be noted that the Company has only $690,000 remaining in long-term debt, all of it interest-free.

Working capital, which has been rising steadily in the past five years, gained about $10 million for the second year in a row to stand at $65.4 million at April 4, 2003. The working capital ratio improved to 3.82:1 in fiscal 2002-2003, up from 3.38:1 at year-end 2001-2002.

CHANGES IN ACCOUNTING POLICIES

On April 6, 2002, the Company retroactively adopted the recommendations of the Canadian Institute of Chartered Accountants with respect to the disclosure of foreign exchange gains and losses and restated the financial statements for the prior years. The new recommendations require that the exchange gains or losses included in earnings be disclosed in the statement of earnings. A foreign exchange loss of $598,000 in 2001-2002 has been reclassified from interest expense for comparative purposes with a gain of $522,000 for fiscal 2002-2003.

On April 6, 2002 the Company adopted prospectively the recommendations of the Canadian Institute of Chartered Accountants on disclosure for stock-based compensation to non employees and employees. Under these new standards, a company that does not adopt the fair value method of accounting for its awards granted to employees is required to include in its financial statements pro forma disclosures of net income and earnings per share as if the fair value method of accounting had been applied.

RISKS AND UNCERTAINTIES

Shermag operates in an industry that bears a variety of risk factors and uncertainties. The Company's business, financial condition and results of operations could be materially adversely affected by any of the risks and uncertainties described below. The risks and uncertainties described below are not the only ones facing the Company. Additional risks and uncertainties not presently known to the Company or that it currently believes to be immaterial may also adversely affect its business.

Economic Conditions and Competition

Furniture is a highly discretionary purchase and considered a vulnerable sector in times of economic contraction and instability. Furthermore, competition in the North American furniture industry is fierce and increasing with rising imports from Asia.

Raw Material Costs

An important risk in the furniture sector is the availability of Shermag's main raw material, rough timber. The Company has reduced this risk through its vertical integration strategy of acquiring hardwood sawmills through which it has ownership rights in a Timber Supply and Forest Management Agreement and negotiated log supply contracts.

Changing Customer Trends

The residential furniture business is fashion oriented and dependent on the tastes and budgets of consumers. Shermag attempts to mitigate the risk of changing consumer trends by offering a broad selection of reasonably priced products, and regularly introducing new furniture collections.

Dependency on the U.S. Marketplace

The Company generated 73% of its annual sales in fiscal 2002-2003 in the United States, thereby placing great reliance upon the state of the American economy. With the current global unrest contributing to economic uncertainty, the North American market outlook is cautious at best. Any significant economic event involving the United States could have a material impact on the Company's results.

Foreign Exchange

Exports to the United States account for approximately 73% of the Company's sales. Only a portion of the Company's raw materials and operating costs are paid in U.S. dollars. Thus, the Company normally has a liquidity surplus of U.S dollars. Major fluctuations in the value of the U.S. dollar versus the Canadian dollar represent potential risk for Shermag.

Management's Discussion and Analysis
of Operating Results and Financial Position

The acquisition of Jaymar in early fiscal 2003-2004, broadens the Company's product offering and provides access to new markets.

To offset the negative effect of a sudden change in the exchange rate, Shermag has an internal hedging policy whereby the Company uses financial instruments such as forward exchange contracts to cover a certain percentage of its anticipated net receipts in U.S. dollars. The amount of coverage declines over time and is spread over a maximum of 24 months.

As at April 4, 2003, forward exchange contracts entered into by the Company totalled US$60 million at an average exchange rate of 1.5834, spread out over a period ending in December 2004.

In the event that it has insufficient liquidity in U.S. dollars to meet its commitments, the Company can borrow on margin in U.S. dollars as well as Canadian dollars, or defer some foreign exchange contracts.

Environment
Like other manufacturers of wood furniture, Shermag is subject to the requirements of environmental laws and regulations pertaining to discharge and waste-disposal management. Management believes that its operations comply in all material respects with all environmental laws and regulations.

Legal Actions
Shermag is not involved in any legal actions that, in management's opinion, could have a material adverse effect on Shermag's financial position or results of operations.

OUTLOOK

The North American economy continues to present a challenging environment for business. With the reduction in trade barriers throughout the 1990s and the subsequent market globalization, competition, already high in the furniture industry, is growing. At the same time, given the strong housing activity over the last few years, there should be considerable demand for furniture.

Shermag is well placed to face the challenge. In addition to continuously updating and adding collections, the Company's divisions are renewing efforts to ensure competitiveness by reducing manufacturing costs and delivery times. The Import division is on top of the trend toward sourcing in lower-cost Asian countries, and is growing steadily. The acquisition of Jaymar in early fiscal 2003-2004, broadens the Company's product offering and provides access to new markets. Nonetheless, Shermag must remain cautious and flexible to change.

Management's Report

Shermag Inc.'s consolidated financial statements for the years ended April 4, 2003 and April 5, 2002 and the financial information included in this annual report are the responsibility of management. The consolidated financial statements have been prepared in accordance with generally accepted accounting principles in Canada and with the policies set forth in the notes to said statements.

The Audit Committee of the Board is responsible for reviewing the consolidated financial statements in detail, for ensuring that the Company's internal control systems, management policies and accounting practices are adhered to, and for recommending approval of the consolidated financial statements to the Board of Directors.

The chartered accountants, Raymond Chabot Grant Thornton, have audited the consolidated financial statements which appear hereinafter and their report indicates the extent of their audit and their opinion on said consolidated financial statements.

Jeffrey K. Casselman
President and Chief Executive Officer

Josée Girard, CA
Vice-president, Finance

Auditors' Report

To the Shareholders of Shermag Inc.

We have audited the consolidated balance sheets of Shermag Inc. as at April 4, 2003 and April 5, 2002 and the consolidated statements of earnings, retained earnings and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at April 4, 2003 and April 5, 2002 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

Raymond Chabot Grant Thornton

Chartered Accountants

Sherbrooke, Québec
May 16, 2003

Shermag

2002-2003 Consolidated financial statements

Consolidated Earnings

Years ended April 4, 2003 and April 5, 2002
(Amounts in thousands of dollars, except earnings per common share)

	2003-04-04 (52 weeks)	2002-04-05 (53 weeks)
	$	$
Gross revenue	**195,464**	165,657
Less: returns, allowances and discounts	**14,167**	12,860
Net revenue	**181,297**	152,797
Cost of sales	**124,953**	107,799
Gross profit excluding amortization	**56,344**	44,998
Selling and administrative expenses	**25,027**	24,182
Financial expenses	**449**	1,690
Exchange loss (gain)	**(522)**	598
Amortization	**6,855**	7,492
	31,809	33,962
Earnings before income taxes	**24,535**	11,036
Income taxes (Note 6)	**8,379**	3,864
Net earnings	**16,156**	7,172
Earnings per common share (Note 7)		
Basic	**1.22**	0.54
Diluted	**1.20**	0.54

The accompanying notes are an integral part of the consolidated financial statements.

Consolidated Retained Earnings

Years ended April 4, 2003 and April 5, 2002
(Amounts in thousands of dollars)

	2003-04-04 (52 weeks)	2002-04-05 (53 weeks)
	$	$
Balance, beginning of year	**59,202**	52,030
Net earnings	**16,156**	7,172
Balance, end of year	**75,358**	59,202

The accompanying notes are an integral part of the consolidated financial statements.

Consolidated Cash Flows

Years ended April 4, 2003 and April 5, 2002
(Amounts in thousands of dollars)

	2003-04-04 (52 weeks)	2002-04-05 (53 weeks)
	$	$
OPERATING ACTIVITIES		
Net earnings	**16,156**	7,172
Non-cash items		
Amortization	**6,855**	7,492
Amortization of deferred credits	**(212)**	(229)
Loss on disposal of assets	**17**	73
Future income taxes	**366**	12
Changes in working capital items (Note 5)	**(242)**	9,898
Cash flows from operating activities	**22,940**	24,418
INVESTING ACTIVITIES		
Property, plant and equipment	**(2,406)**	(2,096)
Disposal of property, plant and equipment	**77**	112
Deferred charges	**(1,614)**	(2,220)
Cash flows from investing activities	**(3,943)**	(4,204)
FINANCING ACTIVITIES		
Net change in bank loans and acceptances	**(5,759)**	(14,368)
Instalments on long-term debt	**(10,026)**	(1,520)
Issues of shares	**19**	752
Cash flows from financing activities	**(15,766)**	(15,136)
Net increase in cash and cash equivalents	**3,231**	5,078
Cash and cash equivalents, beginning of year	**2,827**	(2,251)
Cash and cash equivalents, end of year	**6,058**	2,827

The accompanying notes are an integral part of the consolidated financial statements.

Consolidated Balance Sheets

April 4, 2003 and April 5, 2002
(Amounts in thousands of dollars)

	2003-04-04	2002-04-05
	$	$
ASSETS		
Current assets		
Cash and cash equivalents	**6,058**	2,827
Accounts receivable (Note 8)	**30,919**	28,229
Income taxes receivable	**132**	339
Inventories (Note 9)	**50,496**	45,897
Prepaid expenses	**1,020**	879
	88,625	78,171
Property, plant and equipment (Note 10)	**56,102**	58,318
Other assets (Note 11)	**2,786**	3,499
Future income taxes (Note 6)	**375**	612
	147,888	140,600
LIABILITIES		
Current liabilities		
Bank loans and acceptances (Note 12)		5,759
Accounts payable and accrued liabilities	**18,630**	15,471
Income taxes payable	**4,321**	499
Instalments on long-term debt	**227**	1,427
	23,178	23,156
Long-term debt (Note 13)	**463**	9,289
Deferred credits	**3,252**	3,464
Future income taxes (Note 6)	**7,298**	7,169
	34,191	43,078
SHAREHOLDERS' EQUITY		
Capital stock (Note 14)	**38,339**	38,320
Retained earnings	**75,358**	59,202
	113,697	97,522
	147,888	140,600

The accompanying notes are an integral part of the consolidated financial statements.

On behalf of the Board,

Jeffrey K. Casselman
Director

Arthur P. Earle
Director

April 4, 2003 and April 5, 2002
(Amounts in the tables are in thousands of dollars)

1 - GOVERNING STATUTES AND NATURE OF OPERATIONS

The Company, incorporated under Part IA of the Companies Act (Québec), manufactures furniture.

2 - CHANGES IN ACCOUNTING POLICIES

Foreign currency translation

On April 6, 2002, the Company retroactively adopted the recommendations of the Canadian Institute of Chartered Accountants with respect to the disclosure of foreign exchange gains and losses and restated the financial statements for prior years. The new recommendations require that the exchange gains or losses included in earnings be disclosed in the statement of earnings. A foreign exchange loss of $598,000 in 2002 has been reclassified from interest expense for comparative purposes.

Stock-based compensation and other stock-based payments

On April 6, 2002 the Company adopted prospectively the recommendations of the Canadian Institute of Chartered Accountants Handbook Section 3870 "Stock-based Compensation and Other Stock-based Payments". This Section defines recognition, measurement and disclosure standards for stock-based compensation to non-employees and employees. Under these new standards, all stock-based payments made to non-employees must be systematically accounted for in the enterprise's financial statements. These standards define a fair value-based method of accounting and encourage entities to adopt this method of accounting for its stock-based employee compensation plans.

Under this method, compensation cost should be measured at the grant date based on the fair value of the award and should be recognized over the related service period. An entity that does not adopt the fair value method of accounting for its awards granted to employees is required to include in its financial statements pro forma disclosures of net income and earnings per share as if the fair value method of accounting had been applied. The Company has adopted the latter alternative treatment. The supplementary information required by this new Section is presented in Note 15.

Earnings per share

On March 31, 2001, the Company adopted, on a retroactive basis, the recommendations of the Canadian Institute of Chartered Accountants with respect to Section 3500 "Earnings per share". Under the new recommendations, the treasury stock method is to be used, instead of the current imputed earnings approach, for determining the dilutive effect of stock options. All prior diluted earnings per share amounts have been recalculated in accordance with the new requirements.

3 - ACCOUNTING POLICIES

Use of estimates

The preparation of financial statements in conformity with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts recorded in the financial statements and notes to financial statements. Actual results could differ from those estimates.

Principles of consolidation

The financial statements include the accounts of the Company and its wholly-owned subsidiaries.

Recognition of revenue

Revenue is recognized when significant risks and benefits inherent to ownership have been transferred. This normally occurs upon delivery of product to the customer.

Cash and cash equivalents

The Company's policy is to present cash and temporary investments having a term of less than three months from the acquisition date with cash and cash equivalents.

Inventory valuation

Finished goods and goods in process are valued at the lower of cost and net realizable value. Cost is determined by the average cost method.

Raw materials and supplies are valued at the lower of cost and replacement cost. Cost is determined by the first in, first out method.

April 4, 2003 and April 5, 2002
(Amounts in the tables are in thousands of dollars)

3 - ACCOUNTING POLICIES (Continued)

Amortization

Property, plant and equipment are amortized over their estimated useful lives according to the following methods, periods and annual rates:

	Methods	Rates and periods
Buildings	Straight-line	40 years
Machinery and equipment	Diminishing balance	10%
Rolling stock, software	Diminishing balance	30%
Office furniture	Diminishing balance	20%
Leasehold improvements	Straight-line	5 years
Forestry properties	Straight-line	25 years

Deferred charges are amortized according to the straight-line method over periods not exceeding five years.

Deferred credits represent government grants and investment tax credits resulting from the acquisition of property, plant and equipment. The grants and tax credits are accounted for as deferred credits and amortized according to the same annual methods and rates as the assets to which they relate.

Income taxes

The Company uses the tax liability method to account for income taxes. Under this method, future tax assets and liabilities are determined according to differences between their respective carrying amounts and tax bases. They are measured by applying enacted or substantively enacted tax rates and laws at the date of the financial statements for the years in which the temporary differences are expected to be recovered or settled.

Earnings per share

Basic earnings per common share are computed by dividing the net earnings available to common shareholders by the weighted average number of common shares outstanding during the period. Diluted earnings per share are calculated giving effect to the potential dilution that would occur if securities or other contracts to issue common shares were exercised or converted to common shares at the later of the beginning of the year or the issuance date. The treasury stock method is used to determine the dilutive effect of stock options. The treasury stock method assumes that proceeds received from the exercise of in-the-money stock options are used to repurchase common shares at the average market price during the period.

Stock-based compensation

The Company has a stock-based compensation plan, described in Note 15, for which no compensation expense is recognized when stock options are issued to employees. Any consideration paid by employees on exercise of stock options or purchase of stock is credited to capital stock. Since the Company does not account for options granted to employees using the fair value method, it discloses pro forma information related to net income and earnings per share figures, which are calculated as if the entity applied the fair value method of accounting to stock options granted to employees.

Foreign currency translation

Monetary assets and liabilities in foreign currency are translated at exchange rates in effect at the balance sheet date, whereas other assets and liabilities are translated at exchange rates in effect at the transaction date. Revenue and expenses in foreign currency are translated at the monthly average rate in effect, with the exception of amortization, which is translated at the historical rate. Gains and losses are included in earnings for the year.

Assets and liabilities of the self-sustaining foreign subsidiary are translated into Canadian dollars at the exchange rate in effect at the balance sheet date. Revenue and expenses are translated at the average rate in effect during the year. Gains and losses are included in the "Accumulated exchange adjustments" account of the shareholders' equity, if applicable.

Forward exchange contracts

The Company enters into forward exchange contracts to manage its currency risk exposure. Forward exchange contracts which are part of a hedging relationship are presented at cost. Positions hedged by forward exchange contracts are converted using the contract rate and the gains or losses are recognized to earnings during the year in which the revenue or expenses resulting from the corresponding hedged position are recorded. Forward exchange contracts which are not part of a hedging relationship are recognized at fair value. Resulting gains or losses are recognized to earnings in the current year.

April 4, 2003 and April 5, 2002

(Amounts in the tables are in thousands of dollars)

4 - INFORMATION INCLUDED IN THE STATEMENT OF EARNINGS

	2003-04-04 (52 weeks)	2002-04-05 (53 weeks)
	$	$
Amortization of property, plant and equipment	**4,528**	4,712
Amortization of deferred charges	**2,280**	2,720
Amortization of goodwill	**47**	60
Amortization of deferred credits	**212**	229
Interest on short-term debt	**229**	1,173
Interest on long-term debt	**220**	517

5 - INFORMATION INCLUDED IN THE STATEMENT OF CASH FLOWS

The changes in working capital items are detailed as follows:

	2003-04-04 (52 weeks)	2002-04-05 (53 weeks)
	$	$
Accounts receivable	**(2,690)**	4,951
Income taxes receivable	**207**	(65)
Inventories	**(4,599)**	6,260
Prepaid expenses	**(141)**	(129)
Accounts payable and accrued liabilities	**3,159**	(322)
Income taxes payable	**3,822**	(797)
	(242)	9,898

Cash flows relating to interest and income taxes on operating activities are detailed as follows:

	2003-04-04 (52 weeks)	2002-04-05 (53 weeks)
	$	$
Interest paid	**468**	1,696
Income taxes paid	**3,984**	4,714

April 4, 2003 and April 5, 2002
(Amounts in the tables are in thousands of dollars)

6 - INCOME TAXES

a) Provision

	2003-04-04 (52 weeks)	2002-04-05 (53 weeks)
	$	$
Income taxes are detailed as follows:		
Current	**8,013**	3,852
Future	**366**	12
	8,379	3,864

The difference between the Company's effective income tax rate and the combined Federal and Provincial income tax rate in Canada is explained as follows:

	2003-04-04	2002-04-05
	%	%
Income taxes at the combined Federal and Provincial income tax rate in Canada	**39.2**	39.2
Manufacturing and processing profits deduction	**(6.8)**	(6.8)
Future income tax benefit not recorded		1.8
Permanent differences and other	**1.8**	0.8
Income taxes at the Company's effective income tax rate	**34.2**	35.0

b) Future tax assets and liabilities

Future tax assets and liabilities consist of the following temporary differences:

	2003-04-04	2002-04-05
	$	$
Future tax assets		
Losses carry-forward for tax purposes	**375**	612
Future tax liabilities		
Book value in excess of tax basis		
Property, plant and equipment	**6,696**	6,662
Deferred charges	**602**	507
	7,298	7,169

The future income tax asset resulting from allowable capital losses is not recorded in the financial statements. These losses amount to $1,832,000 and may be carried-forward and applied against taxable capital gains over an indefinite period.

7 - EARNINGS PER SHARE

The following table shows a reconciliation between basic earnings and diluted earnings per common share:

	2003-04-04 (52 weeks)	2002-04-05 (53 weeks)
Net earnings	**$16,156**	$7,172
Weighted average number of common shares outstanding	**13,295,501**	13,209,945
Effect of dilutive stock options	**182,834**	113,539
Weighted average diluted common shares outstanding	**13,478,335**	13,323,484
Basic earnings per common share	**$1.22**	$0.54
Diluted earnings per common share	**$1.20**	$0.54

April 4, 2003 and April 5, 2002
(Amounts in the tables are in thousands of dollars)

8 - ACCOUNTS RECEIVABLE

	2003-04-04	2002-04-05
	$	$
Trade accounts		
Canada	**7,243**	6,963
United States	**21,641**	20,149
	28,884	27,112
Sales taxes receivable	**1,282**	740
Others	**753**	377
	30,919	28,229

89% (90% in 2002) of trade accounts receivable are secured upon shipping by a global multirisk insurance policy.

9 - INVENTORIES

	2003-04-04	**2002-04-05**
	$	$
Finished goods	**29,783**	20,204
Goods in process	**6,988**	10,803
Raw materials	**12,335**	13,339
Supplies	**1,390**	1,551
	50,496	45,897

10 - PROPERTY, PLANT AND EQUIPMENT

		2003-04-04	
	Cost	**Accumulated amortization**	**Net**
	$	**$**	**$**
Land	**2,101**		**2,101**
Buildings	**30,735**	**6,333**	**24,402**
Machinery and equipment	**44,081**	**20,192**	**23,889**
Rolling stock	**1,286**	**873**	**413**
Office furniture	**6,579**	**4,254**	**2,325**
Software	**5,304**	**3,434**	**1,870**
Leasehold improvements	**964**	**379**	**585**
Forestry properties	**696**	**179**	**517**
	91,746	**35,644**	**56,102**

		2002-04-05	
	Cost	Accumulated amortization	Net
	$	$	$
Land	2,078		2,078
Buildings	30,267	5,587	24,680
Machinery and equipment	43,380	17,866	25,514
Rolling stock	1,280	782	498
Office furniture	5,896	3,872	2,024
Software	4,941	2,720	2,221
Leasehold improvements	949	189	760
Forestry properties	696	153	543
	89,487	31,169	58,318

April 4, 2003 and April 5, 2002
(Amounts in the tables are in thousands of dollars)

11 - OTHER ASSETS

	2003-04-04	2002-04-05
	$	$
Deferred charges, at amortized cost		
New product development costs	**752**	1,111
Pre-operating costs	**669**	1,007
Promotional tools	**1,353**	1,284
Financing charges	**12**	50
	2,786	3,452
Goodwill, at amortized cost		47
	2,786	3,499

12 - BANK LOANS AND ACCEPTANCES

The Company has total authorized operating credits of $32,500,000, which can be used as bank loans or acceptances. These amounts can be drawn out in Canadian or American dollars. The bank loans bear interest at the Canadian prime rate, US prime rate or bank acceptance rate; these rates are reviewed on a quarterly basis. The operating credits are established for a three-year term, renewable on September 30 of each year for an additional year and are subject to the securities and restrictions mentioned in Note 13 (*).

13 - LONG-TERM DEBT

	2003-04-04	2002-04-05
	$	$
Non-interest bearing loans from a gouvernment agency, payable in monthly and annual instalments, maturing at various dates until 2007	**690**	916
Loan, prime rate plus 0.5% (*)		9,800
	690	10,716
Instalments due within one year	**227**	1,427
	463	9,289

(*) This loan as well as the short-term bank loans and acceptances are secured by a first rank mortgage on the universality of all present and future movable and immovable, tangible and intangible assets, for an amount of $70,000,000. The Company is subject to certain restrictions under the credit agreement. As at April 4, 2003, the Company was in compliance with these restrictions.

The instalments on long-term debt for the next years are $226,780 in 2004, $216,820 in 2005, $200,455 in 2006 and $45,443 in 2007.

April 4, 2003 and April 5, 2002
(Amounts in the tables are in thousands of dollars)

14 - CAPITAL STOCK

Authorized
Unlimited number of common shares, without par value, voting and participating

Unlimited number of preferred shares of first and second rank, without par value, which can be issued in one or more series, for which the directors will determine their number, designation, rights, privileges, conditions and restrictions

Preferred shares of second rank, series 1, annual and non-cumulative dividend of $0.06 per share, non-voting, non-participating, redeemable at the Company's option at the paid-up capital amount

	2003-04-04		2002-04-05	
	Number of shares	**Amount**	Number of shares	Amount
		$		$
Issued and fully paid				
Common shares				
Balance, beginning of year	**13,292,724**	**37,871**	13,184,474	37,119
Stock options exercised for cash	**3,000**	**19**	108,250	752
Balance, end of year	**13,295,724**	**37,890**	13,292,724	37,871
Preferred shares of second rank, series 1				
Balance, beginning and end of year	**700,000**	**449**	700,000	449
		38,339		38,320

15 - STOCK-BASED COMPENSATION

The Company has reserved 800,000 common shares under the terms of a stock purchase option plan for key employees and directors. From this number and since the creation of this plan, 114,250 options have been exercised. The number of non-attributed options stands at 67,500. The exercise price of options is established at the quoted market price of outstanding shares on the day preceding the day the options are granted. The period, terms and conditions of these options are determined by the Board of Directors. It is provided however that the options expire at the latest ten years following the date they are granted.

April 4, 2003 and April 5, 2002
(Amounts in the tables are in thousands of dollars)

15 - STOCK-BASED COMPENSATION (Continued)

The Company's stock option plan is as follows:

	2003-04-04		2002-04-05	
	Options	**Weighted average exercise price**	Options	Weighted average exercise price
		$		$
Options outstanding, beginning of year	**614,250**	**9.33**	729,500	9.00
Options granted	**23,000**	**11.40**		
Options exercised	**(3,000)**	**6.25**	(108,250)	6.95
Options cancelled	**(1,000)**	**13.80**	(7,000)	10.73
Options expired	**(15,000)**	**13.80**		
Options outstanding, end of year	**618,250**	**9.31**	614,250	9.33
Options that can be exercised at year end	**503,250**		391,750	

Summary of options outstanding as at April 4, 2003:

		Total outstandings		Total exercisable	
Options	Exercise price	Weighted average exercise price	Contractual remaining life	Options	Weighted average exercise price
	$	$			$
377,000	6.25 - 9.00	6.41	6.6 years	262,000	6.43
241,250	11.40 - 17.00	13.84	5.3 years	241,250	13.84
618,250		9.31	6.1 years	503,250	9.98

The Company does not record any compensation expense for stock options granted to employees. Had compensation cost for the Company's stock-based compensation plan been determined using the fair value-based method at the grant date, the net income and earnings per share would have been reduced to the pro forma amounts indicated in the following table:

	2003-04-04 (52 weeks)
	$
Net earnings as presented	**16,156**
Net earnings pro forma	**16,041**
Basic earnings per share as presented	**1.22**
Basic earnings per share pro forma	**1.21**
Diluted earnings per share as presented	**1.20**
Diluted earnings per share pro forma	**1.19**

The pro forma effect on net income of the period is not representative of the pro forma effect on net income of future periods because it does not take into consideration the pro forma compensation cost related to options awarded prior to April 6, 2002.

The fair value of each option granted was estimated on the grant date using the Black-Scholes option-pricing model with the following assumptions for awards granted since the beginning of year:

Expected dividend yield	0%
Expected volatility	43%
Risk-free interest rate	4.3%
Expected life	5 years

The fair value of each option granted since the beginning of year was $4.99.

April 4, 2003 and April 5, 2002
(Amounts in the tables are in thousands of dollars)

16 - COMMITMENTS

The Company has entered into long-term lease agreements, expiring at the latest in 2006, which call for lease payments of $1,631,553 for the rental of premises. Minimum lease payments for the next years are $685,084 in 2004, $631,713 in 2005 and $314,756 in 2006.

17 - FAIR VALUE OF THE FINANCIAL INSTRUMENTS

Primary financial instruments

Cash and cash equivalents, accounts receivable and other receivables, bank loans and acceptances, accounts payable and accrued liabilities are short-term financial instruments whose fair value approximates their carrying amount given that they will mature shortly.

The fair value of the long-term loan at prime plus 0.5% is equivalent to its carrying amount given that its interest rate varies according to the market. The fair value of long-term non-interest bearing loans was undeterminable based on loans with similar terms, conditions and maturity dates.

Fair value of derivative financial instruments

The Company concludes forward exchange contracts to sell amounts of currency in the future at predetermined exchange rates. These forward exchange contracts protect the Company from its risk exposure to future exchange rate fluctuations. The total amount of committed sales of currencies is US$60,000,000 (US$73,000,000 in 2002). The fair value of derivative financial instruments is determined based on prices obtained from the brokers of the Company's financial institution for identical or similar financial instruments. The following tables summarize the amounts of committed sales of currencies, the average rate and the favorable (unfavorable) fair value of forward exchange contracts according to their terms:

			2003-04-04
Term	**$US**	**Average rate**	**Fair value**
	$		**$**
1 to 12 months	**43,000**	**1.5840**	**4,077**
13 to 21 months	**17,000**	**1.5820**	**1,107**
	60,000	**1.5834**	**5,184**

			2002-04-05
	$US	Average rate	Fair value
	$		$
1 to 12 months	61 000	1.5559	(2,550)
13 to 18 months	12 000	1.6041	29
	73 000	1.5638	(2,521)

18 - GEOGRAPHIC BREAKDOWN OF REVENUE

The Company's revenue can be broken down geographically as follows:

	2003-04-04 (52 weeks)	2002-04-05 (53 weeks)
	$	$
Canada	**52,127**	45,912
United States	**143,337**	119,745
	195,464	165,657

19 - SUBSEQUENT EVENTS

On May 12, 2003, the Company concluded an agreement for revolving bank credits of a total maximum amount of $100,000,000. A revolving bank credit in the amount of $40,000,000 is available for the Company's current operations for an initial revolving period of three years, with a possible extension on demand for an additional year at each anniversary date of the agreement. A revolving bank credit in the amount of $60,000,000 is available for purposes of financing existing loans, possible business acquisitions and current operations. This latter revolving bank credit is available for an initial revolving period of 364 days plus a three-year term period. The revolving period of 364 days can be renewed each year on demand. The credits are available as loans and bear interest at the Canadian prime rate, US prime rate, LIBOR rate or bank acceptances rate. This new agreement replaces the outstanding operating credit agreement in effect on April 4, 2003.

On May 16, 2003, the Company acquired all of the outstanding shares of Jaymar Furniture Company, for an approximate amount of $27,200,000 plus a maximum conditional amount of $4,500,000, based on expected financial results. Jaymar Funiture Company manufactures upholstered furniture. This acquisition is financed with the bank credits mentioned in the preceding paragraph.

BOARD OF DIRECTORS

Claude Pichette [1]
Chairman of the Board
Shermag Inc.
General Manager
Fondation Armand-Frappier

Jeffrey K. Casselman [1]
President and
Chief Executive Officer
Shermag Inc.

Charles Chamard [2]
Corporate Director

Arthur P. Earle, C.M., FEIC [1] [2]
Consultant

Jean-Côme Gaudet [2]
Corporate Director

John LeBoutillier [3]
Chairman of the Board
Intellium Technologies Inc.

John D. Thompson [1] [3]
Deputy Chairman
Montréal Trust

Jeanne Wojas [3]
Lawyer and Corporate Director

[1] Member of the Executive Committee
[2] Member of the Audit Committee
[3] Member of the Human Resources Committee

MANAGEMENT

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President and
Chief Executive Officer

Larry Beasley
Vice-president, Marketing

Josée Bélanger
Corporate Secretary

Guy Cardinal
Vice-president, Production

Michel Fortin
Vice-president, Human Resources & Organizational Development

Josée Girard
Vice-president, Finance

Bob Régimbald
Vice-president
Customer Service & Logistics

CORPORATE INFORMATION

Transfer Agent
National Bank Trust
1100 University Street
Montréal (Québec)
H3B 9Z9

Auditors
Raymond Chabot Grant Thornton
Sherbrooke (Québec)

Bank
National Bank of Canada

Stock Registration
Shermag Inc.'s shares are listed on the Toronto Stock Exchange under symbol SMG.

Annual Information Form and General Information
To obtain a copy of the Annual Information Form submitted to the Québec Securities Commission and the Ontario Securities Commission or for any additional information regarding the Company, please send a written request to the Company's Secretary or to the Transfer Agent.

Annual General Meeting of Shareholders
Wednesday, August 20, 2003
at 10:30 a.m.
Marriott Château Champlain
1 Place du Canada
Montréal (Québec)

DIVISIONS

BÉDARD
Émile Hudon, President

7025, rue des Châtaigniers
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Granby (Québec)
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726, rue Principale
Saint-Étienne-de-Lauzon (Québec)
G6J 1J5

CHANDÉRIC
Benoit Racine, President

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Canton Eaton (Québec)
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Saint-François-de-Madawaska
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HPL
Mike Lavoie, President

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Sherbrooke (Québec)
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JAYMAR [1] [2]
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SCOTSTOWN
Claude O'Reilly, President

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Bishopton (Québec)
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510, rue Saint-François
Disraeli (Québec)
G0N 1E0

10, rue Albert
Scotstown (Québec)
J0B 3B0

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Pierre Beaudet, General Manager

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SAWMILLS & VENEER

MÉGABOIS INC. [1]
Marc L'Écuyer, General Manager

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C.P. 187
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G6B 2S6

MONTAUBAN INC. [1]
Marc L'Écuyer, General Manager

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SHERMAG CORP. dba WOODTEK [1]
Marc L'Écuyer, General Manager

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USA

PLACAGES LENNOX
Guy Dufresne, Plant manager

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[1] Wholly-owned subsidiary
[2] Since May 16, 2003

Shermag

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